



The Fertilizer Institute

Nourish, Replenish, Grow

Testimony of

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on behalf of

The Fertilizer Institute

Before the

**U.S. House Committee on Resources, Subcommittee on
Energy and Mineral Resources**

Regarding

**The High Price of Natural Gas
and its Impact on the U.S. Fertilizer Industry**

DESCRIPTION OF TESTIMONY

A description of Terra Industries Inc. and the impact of high natural gas prices on the company and its customers.

November 17, 2005

INTRODUCTION

Mr. Chairman and members of the subcommittee, I am Mike Bennett, president and chief executive officer of Terra Industries Inc. On behalf of Terra and The Fertilizer Institute (TFI) of which Terra is a member, I appreciate the opportunity to testify before the House Committee on Resources, Subcommittee on Energy and Minerals Resources regarding the high price of natural gas and its impact on Terra and its customers. Furthermore, I would like to thank you, Mr. Chairman, for scheduling this important hearing and for your leadership in addressing the critical issue of increasing this nation's supply of natural gas, which is so vital to the U.S. plant food industry, its many local retail agribusiness outlets and the farmers and livestock producers they serve.

Terra

Terra Industries Inc. is a leading international producer of nitrogen products, which we sell to industrial customers and agribusiness dealers for eventual sale to farmers. The company employs approximately 1,200 people in North America and the United Kingdom, and is headquartered in Sioux City, Iowa. Terra is traded on the New York Stock Exchange.

Terra owns and operates seven nitrogen products manufacturing facilities, four of which are in the Midwestern and Southeastern United States, providing good-paying jobs to about 750 U.S. citizens.

TFI

TFI is the leading voice of the nation's fertilizer industry, representing the public policy, communication and statistical needs of fertilizer producers, retailers and transporters. In addition to energy policy, issues of interest to TFI members include the environment, international trade, security, transportation and worker health and safety.

FERTILIZER AND ENERGY

The United States needs reliable and plentiful supplies of natural gas to produce nitrogen and meet critical agriculture and food production needs. Natural gas is the primary purchased feedstock ingredient for the production of nitrogen fertilizer and represents as much as 90 percent of the cash cost to produce anhydrous ammonia—the building block for most other forms of commercial nitrogen plant nutrients. The nitrogen fertilizer industry uses approximately two percent of the total natural gas consumed in the nation.

Nitrogen Fertilizers

Anhydrous ammonia is the source of nearly all the nitrogen fertilizer produced in the world. Ammonia is produced by combining nitrogen with hydrogen. The nitrogen is obtained from the atmosphere, while the hydrogen is obtained from natural gas. At today's gas prices, the cost of natural gas, as I mentioned, accounts for up to 90 percent of the production cost of ammonia. Thus, when U.S. natural gas prices increased significantly beginning in the year 2000, the cost of domestically produced ammonia also rose significantly. Average U.S. ammonia production costs doubled from 1999 to 2003, the latest year for which data are available, and have more than doubled again as natural gas prices have continued to rise.

While fertilizer producers can try to pass along these cost increases, our ability to do so is constrained by the commodity nature of the business and competition from producers in nitrogen exporting countries with access to lower priced gas. As a result, rising U.S. natural gas prices cause producer margins to shrink, eventually turning those profit margins into losses. Consequently, companies are forced to reduce production, temporarily idle, or even permanently close plants depending on the specific economic situation they face.

As a result of the ongoing natural gas crisis in America, 22 nitrogen fertilizer production plants have closed since 1999. Seventeen of those plants— four of them owned by Terra—have closed permanently, representing a 20 percent drop in total production capacity, while five plants remain idle. Operating rates for the U.S. ammonia industry have also declined significantly from historical levels. The permanent and temporary closures in combination with the drop in operating rates have resulted in a 35 percent decline in U.S. ammonia production from nearly 18 million tons of material in the 1998-99 fertilizer year to less than 12 million tons in the 2003-04 fertilizer year. U.S. nitrogen imports have increased from just over 6 million tons to more than 10 million tons in that same period. Consequently, the U.S. fertilizer industry, which typically supplied 85 percent of its domestic needs from U.S.-based production during the 1990s, now relies on imports for nearly 45 percent of nitrogen supplies. This percentage will almost certainly increase in the coming year.

In the past two months alone, three of the largest remaining U.S. nitrogen fertilizer producers, including Terra, have idled a significant portion of their facilities and/or reduced production due to the unprecedented rise in natural gas feedstock costs.

THE IMPACT OF HIGH NATURAL GAS PRICES

On the U.S.

The U.S. natural gas crisis is exacting a heavy toll on America's nitrogen fertilizer producers, our customers and the end-users they supply. The resulting negative financial impact is unprecedented and is irreversibly crippling the U.S. nitrogen fertilizer manufacturing industry, which supplies approximately one-half of U.S. farmers' nitrogen fertilizer needs. America's food security, and by extension, our national security will be jeopardized if we don't take fast and decisive action to address our country's natural gas crisis.

On Terra Industries Inc., our Customers and End-users

It is no exaggeration to say that Terra and other producers with nitrogen manufacturing operations in North America may not survive unless we find a way to lower natural gas prices through increased supply. To illustrate the drastic effect that natural gas prices have on Terra and other nitrogen producers' profitability and viability, consider that a \$1.00 per MMBtu change in the price of natural gas moves Terra's annual operating income by about \$100 million. For the first nine months of 2005, Terra's North American natural gas costs were \$7.66 per MMBtu. At this price, which represents Terra's cost *before* the recent extreme runup in gas prices, Terra's annual cost for natural gas to operate its U.S. plants at capacity would be approximately \$735 million. The NYMEX strip shows natural gas futures prices for 2006 at \$10.86 per MMBtu, which would increase Terra's costs to roughly \$1.2 billion. Such an increase will again raise farmers' fertilizer costs, cause Terra to reduce its return to shareholders and very possibly cause

Terra and other U.S. producers to shut down additional plants.

These extreme conditions are harming our customers and farmers as well. Farmers are facing not only higher fertilizer costs, but also higher costs for other inputs, which are affected by skyrocketing energy costs. The higher input costs also make U.S. farmers less competitive with other countries as they market their crops. These difficult circumstances are causing farmers to delay decisions about what crops they will plant and how much fertilizer they will apply, thereby providing no indication to nitrogen producers or our customers of how to effectively plan for the spring planting and fertilizer application season.

Ironically, the U.S. energy crisis—a direct result of U.S. energy policy—is making the crops we're best suited to grow the least viable in global markets.

CONCLUSION

Actions Taken

Recently, I and many of my colleagues in the nitrogen producing industry met with U.S. Department of Energy Secretary Samuel W. Bodman, as well as a number of key farm-state senators and congressmen. After describing agriculture's natural gas crisis situation, I cannot say in all honesty that we left any of those meetings encouraged about the short- or long-term energy future for our producers, retailers, farmers or nation. Energy conservation, renewable fuels and increased imports of Liquefied Natural Gas (LNG), while important, will not save this nation's nitrogen fertilizer industry from being forced to idle remaining U.S. production capacity because of cost pressures from high natural gas prices. The only way to avoid the further decline of the U.S. fertilizer industry and a nationwide economic disaster in farm country is to increase U.S. supplies of natural gas significantly and as soon as possible.

Recommendations

Mr. Chairman, allow me to relay recommendations toward that end, which we believe should be immediately included in federal energy legislation and policy. These recommendations include opening additional federal lands and off-shore areas to oil and gas exploration and production, especially the lease/sale area 181 in the Gulf of Mexico and other coastal areas on the Outer Continental Shelf (OCS).

Currently, 85 to 90 percent of the OCS is off-limits to natural gas exploration due to a combination of congressional and state moratoria. Industry estimates suggest that the OCS contains gas reserves large enough to supply all current U.S. industrial and commercial needs for 40 years. Regarding "Lease Sale 181," the U.S. Interior Department estimates that the 6 million acre area contains natural gas reserves of 1.3 trillion cubic feet. Terra Industries and TFI strongly believe that opening these areas to natural gas drilling is the fastest way to bring new natural gas to market and bring much needed relief to our industry and our nation's food producers. One option that might go a long way toward achieving these goals is the "Outer Continental Shelf Natural Gas Relief Act" recently introduced by Rep. John Peterson.

Also, any federal policies that can be implemented to make it easier to get permitting and to build new LNG terminals in the United States as quickly as possible are vital. We believe these

federal policy initiatives are critically important to the energy security, food security and our national security.

Finally, Terra Industries and TFI urge members of this subcommittee and all members of Congress concerned about the ongoing U.S. natural gas crisis, to contact Secretary Bodman and request that the U.S. Department of Energy move quickly to promulgate rules and regulations for loan guarantees and investment tax credits for construction of coal gasification facilities as authorized by Congress in the recently enacted federal energy bill.

To conclude, allow me to again thank you Mr. Chairman and members of the subcommittee for your leadership in addressing the critically important issue of high natural gas prices in this country and its impact on the U.S. fertilizer industry and its customers. Thank you for the opportunity to testify today.

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